

# **COUNTY OF PLACER**

OFFICE OF AUDITOR-CONTROLLER

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Mr. Ken Grehm, Public Works Placer County Public Works Department 3091 County Center Drive, Suite 220 Auburn, CA 95603

Re: Year-End Inventory Count Review

Dear Mr. Grehm:

The Internal Audit Division of the Auditor-Controller's Office performed a review of the Fleet Services Division (Division) year-end inventory count made by the Public Works Department (Department) for the period of July 1, 2008 to June 30, 2009. The objectives of our review were to obtain an understanding of the entity's internal control structure, assess the control risks, ensure inventory count is accurate and complete, and make recommendations for improvement.

Based on our review, which consisted of inquiries of Fleet Services staff regarding current processes, procedures employed by the Department, and physical inspection of inventory, we feel the current internal controls over financial reporting are lacking sufficient checks and balances to ensure the safeguarding of assets. Our findings and recommendations are as follows.

Overage/Shortage Accounting of Inventory

We noted on the Division's year-end discrepancy report significant variations between recorded inventory and actual inventory. The total dollar amount of discrepancy was \$42,819.87 for Auburn, which equates to 10% of the Equipment & Parts Inventory in PAS as of May 2009. Likewise, the Lake Tahoe discrepancy report contained \$166,728.55 in errors, which equates to 73% of the total inventories. According to the County's Accounting Policies and Procedures Manual - Inventories, "Departments responsible for maintaining physical inventories must maintain adequate subsidiary records to support the amount recorded in the County general ledger."

We recommend management review the current inventory acquisition and consumption practices and consider adopting a more accurate method to account for all inventories.

## Department Response:

The numbers cited above may be misleading in that they depict gross numbers. By this we understand that the numbers cited above are adding items that have been undercounted and overcounted to each other and do not show the net amount.

The net amount is much different than that depicted above. After review and consultation with the Auditor's office, the net overage/shortage amount is \$7,017 for Auburn garage and \$48,645 for Lake Tahoe garage.

### Auburn:

Auburn currently has \$387,994.75 of inventory. The net shortage amount of \$7,017 for Auburn is below industry standards (assuming a retail industry rate of 3 to 5 %, corresponding anywhere from \$11,639.84 to \$19,399.74 of inventory). We will continue to improve record keeping as further discussed in other items. There is some concern on how we account for obsolete and /or salvaged parts. We will continue to work with the Auditor's office to define the system necessary to account for these appropriately.

### Lake Tahoe:

The net for Lake Tahoe is of concern. While we show a net difference of \$48,645, we have verified that this difference has a few large components. For example, we have identified a discrepancy of over \$14,000 due to 5 large parts (axles) being transferred to the Auburn garage and no paperwork being filed. Another example we have discovered is due to the counting of oil in gallons instead of quarts. We have also identified duplicate part numbérs as well.

We have limitations in the physical layout and facilities of the current Lake Tahoe operation. The parts room itself is small and is not a good physical location for all product materials. It is too small for some products. We concur with the Auditor that record management, stocking, and inventory paperwork needs to be managed better. Currently, this is being done by the 3 mechanics who are the only fleet employees at this facility, and paperwork has been missed particularly during peak/high stress periods (ie snowstorms, etc).

The Lake Tahoe operations will be relocated to a new facility upon completion of the new Cabin Creek garage. This garage is in the final stages of completion, with move in expected sometime this fiscal year.

In short, Lake Tahoe operations will be strengthened by the following actions:

- 1. Relocation to a new modern building where inventory will be kept in a larger and potentially more secure location.
- 2. Inventory will not be as easily accessible. We are working with Facilities staff to provide the most secure facility as reasonably possible.
- 3. The new parts room will be set up using more modern layouts and similar to our Auburn parts room.
- 4. We will have our parts room/"inventory manager" make regular visits to the Lake Tahoe facility to assist in setting up a better system in Tahoe and provide some oversight on practices. The inventory manager will provide feedback to the Fleet Manager.

We will need to periodically review practices and annual discrepancies to continually insure improvement.

**Separation of Duties** 

We noted the authorization of all purchases, ordering inventory, receiving inventory, and recording inventory is done by the same person. This is a violation of the *Accounting Policies and Procedures Manual - Inventories*, "Persons authorizing inventory purchases or payments must not also have custody of the inventory and/or inventory records."

We recommend a manager approve the purchases, a mechanic initial the Parts Order Tag/Motor-Pool Interface verifying all the parts charged were used, and another employee record the adjustments of inventory to reflect the daily usage.

# Department Response:

<u>Auburn</u>: Currently, the Assistant Fleet Manager or Fleet Manager approves all invoices for payment and the Supervising Mechanic review all work orders monthly. The Assistant Fleet Manager's role includes verifying that parts are either charged to a work order or placed in inventory. The parts person does order, receive and record the inventory. Hiring another person or diverting another resource to provide additional checks and balances does not appear to be cost-effective (particularly with the discrepancies we have had). Fleet Services will begin having work orders reviewed weekly by the Supervising Mechanics.

<u>Tahoe</u>: The process is essentially the same except that the Supervising mechanic (or at times the other mechanics) is solely responsible for ordering, receiving and recording. Information from Tahoe is then shipped to Auburn where the Assistant Fleet manager approves invoices and information is inputted into the computer. There is no individual whose direct job duties include managing the Tahoe inventory (except the Supervising Mechanic by default). As discussed in an earlier finding, we are proposing some changes to Tahoe inventory management as we move to the new Cabin Creek maintenance building.

### **Inventory Valuation**

We noted there were 45 inventory items for Auburn and two for Tahoe that were on hand during the physical inventory count, but not in the inventory records. The true value of these items should be added to the corresponding total category.

The Accounting Policies and Procedures Manual - Inventories states departments should, "Maintain separate-item accountability by units and dollars for inventory quantities received, issued, and on hand." We recommend all inventory carry a dollar value to accurately reflect the cost of all inventory. In addition, we recommend separate numbered Parts Inventory Tags be used to track purchases for special projects.

# Department Response:

The 45 inventory items are an assortment of fittings purchased as a single item. Since they would be used individually, each piece was assigned its own part number and placed in inventory. We had no individual pricing and so we sought information from the vendor. Pricing has been provided by the vendor and I believe this situation has been rectified.

## **Securing Inventory**

The inventory room is not always locked and five employees are in possession of keys. According to the *Accounting Policies and Procedures Manual - Inventories*, "Inventories shall be protected against loss, theft, and damage through adequate physical controls; such as locked access and storage facilities."

We recommend the Division ensure the inventory room is locked at all times and counter staff are available to sign out all inventory items requested.

### Department Response:

<u>Auburn</u>: The parts room has a full time employee and is only left unattended for short periods to accept shipments, take breaks, etc. We will modify our practices so that the parts room remains locked at all times when unattended.

<u>Tahoe</u>: Currently the various storage areas and parts room is accessible by all three mechanics. The new building will allow for better consolidation of parts and we will work with facilities to maximize the ability to secure our inventory. All three mechanics will need to have continued access to the parts room. We do not believe that the size of the Tahoe operation warrants the cost of a separate employee to manage the parts function.

### **Inventory Count Date**

Year-end inventory counts are conducted on various dates during late spring. According to the *Accounting Policies and Procedures Manual - Inventories*, departments should "Perform annual inventory on June 30<sup>th</sup>."

We recommend the Division conduct physical inventories on or nearer to June 30<sup>th</sup> for year-end inventory counts.

# Department Response:

The physical inventory check is typically performed in April/May. To provide an accurate June 30 inventory count, we take the physical amount counted in April/May and then reconcile those numbers with purchases and uses between the physical count and June 30. We will perform inventory as close as practical to year end so as not to conflict with other year end closeout functions.

The Department's responses to the recommendations identified in our review are described above. We did not audit the Department's responses and, accordingly, we express no opinion on them.

We appreciate the courtesy and cooperation of the Fleet Services Division staff and the Public Works Department throughout the course of this review.

Nicole C. Howard, CPA Internal Audit Manager cc: Chuck Gordon, Fleet Manager, Public Works Department
Jim Geach, Assistant Fleet Superintendent, Public Works Department
Cynthia Taylor, Senior Administrative Services Officer, Public Works Department
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